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C O N F I D E N T I A L QUITO 000542

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## TREASURY FOR SGOOCH

E.O. 12958: DECL: 03/07/2017

TAGS: [ECON](#) [EFIN](#) [ETRD](#) [PGOV](#) [PINR](#) [SCUL](#) [EC](#)

SUBJECT: ECONOMIC OUTREACH: USFQ SCHOLARS SLAM EX-COLLEAGUE CORREA

REF: A. A) QUITO 91

- ¶B. B) QUITO 248  
¶C. C) QUITO 364  
¶D. D) QUITO 321  
¶E. E) QUITO 290

Classified By: Deputy Chief of Mission Jefferson Brown for Reasons 1.4(b) and (d)

**¶1. (C) Summary:** In a February 28 meeting with EconOffs, academics from the business school at the University San Francisco of Quito (USFQ) engaged in a playful and energetic discussion about the economic policies of their ex-colleague President Rafael Correa. Most expressed concern about what they view as counterproductive reform plans and some expressed alarm at Correa's loosening of fiscal discipline, saying that it could plunge Ecuador into crisis within eighteen months. All agreed that the Correa administration is inexperienced in economic management and that every element of its economic policy is geared toward securing support for Correa's positions in the national constituent assembly to re-write the constitution. End summary.

USFO ) ECUADOR'S ELITE PRIVATE UNIVERSITY

¶ 2. (U) As part of our ongoing outreach efforts to Ecuador's economics academics (reftels A and B), EconOffs met on February 28 with several professors from USFQ's College of Administration, including Dean Dr. Juan Montufar, Economics professors Estuardo Gordillo and former Ecuadorian Minister of Economy Dr. Magdalena Barreiro, Finance professor Roberto Salem, and Marketing professors Nicolas Vasconez and Thomas Gura.

¶3. (U) USFQ is Ecuador's premier private university and is widely seen as a college for "elites". Dr. Montufar said in opening that the College of Administration "must be apolitical", but admitted that many current and former professors have served in public office, including the College's currently most famous ex-professor President Rafael Correa. Dr. Montufar said, possibly by way of explanation of his former colleague's leftist economic views, that USFQ "does not monitor" its classes' content, and that professors enjoyed wide latitude in teaching their subject matter.

## COUNTERPRODUCTIVE REFORM PLANS

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¶ 14. (C) Economics professor Gordillo started the discussion by saying that it was "too early" to make predictions about what the government might do, but that some elements of President Correa's economic platform were "very worrisome." He said that "there was no signature on the FTA" (referring to the abortive U.S.-Ecuador free trade negotiations) and that the government apparently expected, perhaps prematurely, that the ATPDEA trade preferences would continue. Gordillo discussed several elements of Correa's tax reform plan, saying that the proposed reduction in the value-added tax (VAT) from 12% to 10% was intended to "activate domestic demand." Gordillo said that the administration's talk of a new tax on assets was creating worries in the business community, which has prompted a reduction in bank deposits. He said that banks were also concerned about talk of a forced repatriation of funds, interest rate controls, mandated minimums for bank lending, and the possibility that the government might force banks to "assign funds to productive sectors." Gordillo said that banks are professionally managed now (unlike before the 1990s banking crisis), and that in the current atmosphere banks have stopped extending financing. He also said that any financial sector reform will hinder banks' access to financing from international lenders.

¶ 15. (C) Barreiro, who served under Correa before replacing him as Economy Minister during the Palacio government, was the most vocal in the group and said that Correa believes the solution to Ecuador's economic problems is to change the nation's consumption patterns, but whatever increase in domestic demand that might result from the VAT decrease would result in either inflation or increased imports, not in increased sales by Ecuadorian producers. The academics

agreed that Ecuadorian producers have taken a "wait-and-see" attitude toward Correa's policies and have effectively stopped investing. Agricultural producers, for example, led by the flower industry, had been steadily increasing their investment in Ecuador over the past several years, but this trend had slowed in the wake of Correa's election, according to the academics. Marketing professor Gura added that since "so much power rests in the hands of a few monopolies," a "wait-and-see" attitude by Ecuadorian business "puts the brakes on the whole economy." Dr. Barreiro added that one of Ecuador's strongest economic indicators was that income from other sectors has been growing as oil income falls, but that this healthy trend will reverse if investment slows in non-oil sectors. The academics all predicted a shrinking of private participation in every sector and more government interference.

#### WORRIES ABOUT FISCAL POLICY

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¶ 16. (C) Dr. Barreiro launched an in-depth analysis of Correa's fiscal policies, saying that his government's budget had both overestimated government revenues by \$600 - \$800 million and underestimated spending by \$300 million. She also said that Correa's fiscal policy was geared exclusively to ensure that Correa "wins" in the national constituent assembly (CA) up for approval by referendum on April 15, by increasing government handouts (reftel c). Dr. Barreiro said that the Correa government budget was already violating several regulations on fiscal policy, such as the law that mandates that current expenditure must be financed by current earnings. She predicted that in order to support his spending, Correa would have to raid petroleum reserve funds like the Special Account for Social and Productive Reactivation (CEREPS) and the Savings and Contingency Fund (FAC), which he would accomplish by "declaring emergencies," as he recently did when he promised more funds to develop Ecuador's highway system. She said that the Ecuadorian Congress would provide complicity in this effort, and that using these funds to finance current spending would "dismantle the fundamental reason for the funds' existence."

¶ 17. (C) Dr. Barreiro said that it would be easy enough for

Correa to "liberate" the funds from their protective earmarks, but that his government "does not have the capacity to assign" the funds to productive investments, and therefore the funds would be used only to finance current spending. She worried about the sustainability of Correa's fiscal program, saying that it would bankrupt the government in 12-18 months, just long enough for Correa to prepare the ground for the CA, which would take 1.5-2 years to pass. Then, she said, the next government would likelyQ left to deal with the problem. Barreiro said that Ecuador's current economic fundamentals are strong enough that "Correa can commit plenty of errors" in the next two years, "with Congress' help." She said that "a big mouth and a lot of money" can take you a long way in Ecuadorian politics. She said that in two years the theme of the external debt conversation will change from "unwillingness to pay" to "inability to pay."

#### TAKING ON PETROECUADOR

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¶18. (C) The academics agreed that the Correa may be able to make some headway in improving Ecuador's oil infrastructure, but that "it will take time." The Esmeraldas refinery, for instance, would require \$3.2 billion in improvements over the next three years, according to Barreiro. They said that "breaking Social Christian Party control" of Petroecuador would be a great achievement, but that the achievement "would not visible." The academics agreed that new Petroecuador chief Carlos Pareja showed promise and was "not going to commit stupidities." The academics also agreed that new Energy Minister Acosta "is very honest," and were surprised that the Minister who originally "seemed like the government,s most communist" now seems "the most reasonable." Their assessment echoes Post's initial impression of Acosta (reftel d).

#### POLITICS WITH "GREEN EYES"

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¶19. (C) The academics agreed that the government is comprised of "a group of people without political experience", and that "they don,t know how to implement their own rhetoric." Marketing Professor Vasconez expressed concern at Correa's relationship with Chavez, about which, he opined, "the U.S. wasn,t doing much." He said he is worried about the fundamentals that underpin dollarization, saying that Correa is "taking the same steps" that Chavez took in Venezuela. On the other hand, he said, "Morales hasn,t found it so easy" to replicate Chavez' politics in Bolivia. Barreiro interjected that Correa is much more charismatic than Morales. "He has green eyes," she said, referring to his handsome, non-indigenous appearance. Barreiro said that "Correa does not just want to be president of Ecuador; he wants to be a Latin American leader like Chavez for another 20-30 years."

¶10. (C) Barreiro projected that Correa would likely remain popular for the next year, but wondered "how long Correa will be able to present himself as Ecuador's redeemer." The academics cautioned that Correa, by referring to "land reform," "social property," "debt moratorium" and "worker participation," would generated unreasonable expectations he could not meet. They also speculated about the respective influences of Correa's cabinet members. With the exception of Dr. Montufar, there was consensus that Agriculture Minister Carlos Vallejo and Presidential Economic Coordinator Mauricio Davalos were "the most worrisome," especially in regard to their positions on microcredit. Barreiro said they want to increase the size of rural microcredit loans (from \$5,000 to \$500,000), which would benefit large agricultural producers (such as Vallejo and Davalos) and "cause moral hazard problems." The academics all agreed that economy Minister Ricardo Patino is one of the cabinet's most powerful (reftel E), saying "he has Correa,s ear."

#### COMMENT

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¶11. (C) The give-and-take between President Correa's former colleagues at USFQ offered us the most alarmist view we have yet heard from academics of Correa's economic program and prospects. That is not surprising, however, as USFQ tends toward a more center-right and business-oriented perspective.

Their conclusion was that while Correa believes his increased spending will spur domestic demand, his proposed tax, banking, and economic policies will damage Ecuador's fiscal stance and investment climate and cause an economic contraction. Because the negative effects of Correa's program will not be felt within the next year, Correa's economic errors will not affect his currently high popularity (around 80% by most recent polls). We note that Correa's economic policy actions to date have been more moderate and responsible than his proposals, but the USFQ team clearly believes that Correa will sacrifice medium-term economic stability for short-term political expediency. End comment.

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